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ABSTRACT

The fiscal neutrality standard established by courts in recent cases holds that the level of spending for a child's education may not be a function of wealth other than the wealth of the State as a whole. In most States, funds for capital improvements in school districts are even more closely tied to district wealth than are funds for operating expenses. This report examines school construction expenditure trends in several States and discusses several proposals for equalizing expenditures. These proposals include full State funding, power equalizing, and minimum foundation plans. (JF)

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PROBLEMS AND ISSUES OF FISCAL NEUTRALITY IN FINANCING SCHOOL CONSTRUCTION

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PROBLEMS AND ISSUES OF FISCAL NEUTRALITY IN FINANCING SCHOOL CONSTRUCTION

A leading principle enunciated in the flurry of activity in courts across the nation with respect to the legality of existing state school finance schemes prompted this monograph. The central thrust of these legal actions was that, constitutionally, the quality of a child's education could not be contingent upon the taxable wealth of the local school district. Most prominent were the Serrano (California), Rodriguez (Texas), and Van Dusartz (Minnesota) cases; in each the decision rendered held that the funding scheme discriminated against the poor because the quality of a child's education tended to be a function of the wealth of his parents and neighbors, that education in the public schools was a fundamental interest, and that no compelling state interest necessitated maintaining the existing schemes.

Each of the above cases was based upon the system of financing the costs of current operation of the schools, and each of the involved states used substantial amounts of state funds as subsidies to equalize local districts' ability to finance a minimum educational program. Financing of school construction, which in many states is financed solely from local property tax proceeds, was never directly at issue in any of the leading cases.

On March 21, 1973, the United States Supreme Court delivered a 5-4 decision reversing the lower court's finding for Rodriguez. The nation's High Court ruled that Texas school finance laws did not disadvantage any suspect class such as poor people, did not interfere with exercise of a fundamental right, and they did bear a rational relationship to legitimate state purpose.

Just as many observors became much too hopeful of achieving meaningful and rapid school finance reform as a result of the original Serrano, Rodriguez, and Van Dusartz decisions, many now appear to be unduly pessimistic as a result of the U.S. Supreme Court ruling on Rodriguez. However, the majority opinion stated:[1]

> We hardly need add that this court's action today is not to be viewed as placing its judicial imprimatur on the status quo. The need is apparent for reform in tax systems which may well have relied too long and too heavily on the local property tax. And certainly innovative new thinking as to public education, its methods and funding, is necessary to assure both a high level of quality and greater uniformity of opportunity. These matters merit the continued attention of the scholars who already have contributed much by their challenges. But the ultimate solutions must come from the lawmakers and from the democratic pressures of those who elect them.

While the High Court did rule that the Texas system was not unconstitutional, the system's inequities were at least obliquely recognized as problems to be solved by the citizenry through its legislative bodies.

Decisions of state courts may also speed the process of reform. The Rodriguez and Van Dusartz rulings were delivered by federal district courts, but Serrano and several other decisions were also based upon equal protection clauses of the state constitutions. Speaking to this point, an Arizona court stated: "This court can envision a situation where the Arizona appellate courts would not feel bound by any decision of the United States Supreme Court in a case similar to this."[2] The same court also commented that "the state's constitutional mandate that the legislature provide for the establishment of an maintenance of a general and uniform public school

system demonstrates that the people of Arizona have always regarded public education as a fundamental interest."

Implications of the Fiscal Neutrality Rule

A concise definition of the principle of fiscal neutrality, in the Van Dusartz ruling, stated "plainly put, the rule is that the level of spending for a child's education may not be a function of wealth other than the wealth of the state as a whole."[3]

The fiscal neutrality standard, as established by the courts, did not mandate that equal spending be achieved in behalf of each pupil. The Texas court emphasized that the state could "adopt the financial share desired so long as the variations in wealth among the governmentally chosen units do not affect spending for the education of any child."[4]

Defendants in the cases generally argued that local aspirations were well served by the existing systems since varying expenditure levels could be determined, through political processes, by each district. The California Supreme Court rejected that line of defense, stating: "so long as the assessed valuation within a district's boundaries is a major determinant of how much it can spend for its schools, only a district with a large tax base will truly be able to decide how much it really cares about education. The poor district cannot freely choose to spend itself into an excellence which its tax rolls cannot provide. Far from being necessary to promote local

fiscal choice, the present financing system actually deprived the less wealthy districts of that option."[5]

The range of per pupil wealth among school districts within a state may be extremely wide. Studies conducted for the National Educational Finance Project indicated the following financial ability ratios for selected states:[6]

State	Financial ability ratio
Arizona	7.41
California	23.76
Delaware	6.39
Illinois	20.06
Indiana	17.17
Kentucky	8.60
Minnesota	7.40
Texas	84.52
Virginia	6.79

Each ratio represents the quotient between the most able and the least able school districts within each state, based upon the measure of financial ability mandated by each state for local district participation in state grant programs.

Since intra-state per pupil wealth disparities are often quite sizeable, what are the consequences with respect to financing school construction? The Arizona decision[7] included this pertinent comment:

> However, funds for capital improvements in school districts are even more closely tied to district wealth than are funds for operating expenses. The state and county make no contribution whatever to the costs of capital improvements. The capability of a school district to raise money by bond issues is a function of its total assessed valuation.

The preceding quotation would be equally applicable to at least half of the 50 states. Table 1 shows that only 25 states granted funds to local districts for either capital outlay or debt service. Only three states (in 1968-69) were sharing per pupil costs for capital outlay at the 50 percent level or better; nine of the 25 states were granting less than 25 percent of capital outlay costs.

Capital outlay and debt service requirements vary much more widely among school districts within a state than do requirements for current expenditures. The fact that 25 states do not share at all in the funding of these essential elements indicates extreme disequalization of both local fiscal capacity and local tax burden - or, put another way, many of the existing state plans severely violate the principle of fiscal neutrality.

TABLE 1. PERCENT OF STATE SUPPORT OF CAPITAL OUTLAY, 1968-1969

State	Capital outlay expenditure per pupil	Per pupil state support for capital outlay and debt service	Percent state support is of capital outlay	Rank
Hawaii	$188.43	$188.43	100.0	1
Kentucky	45.74	32.45	70.9	2
Connecticut	53.78	28.12	52.3	3
Vermont	102.45	49.60	48.4	4
Delaware	282.91	136.35	48.2	5
Indiana	86.96	41.43	47.6	6
Florida	97.08	44.45	45.8	7
Georgia	63.35	27.93	44.1	8
New York	144.15	59.46	41.2	9
South Carolina	72.79	27.16	37.3	10
Pennsylvania	67.54	23.14	34.3	11
Massachusetts	71.15	22.79	32.0	12
Maryland*	218.29	64.38	29.5	13
Mississippi	57.12	12.18	21.3	14
New Hampshire	104.53	21.35	20.4	15
Tennessee	61.91	12.43	20.1	16
New Jersey	122.04	21.80	17.9	17
Washington	105.00	17.15	16.3	18
Maine	113.28	18.12	16.0	19
Rhode Island	164.20	25.91	15.8	20
North Carolina	53.96	7.60	14.1	21
Utah	127.93	14.89	11.6	22
Alaska	286.14	23.87	8.3	23
Alabama	46.98	2.49	5.3	24
Missouri	109.58	2.02	1.8	25

Source: NEFP, National Capital Outlay Study and NEA Estimates of School Statistics.

*Maryland initiated full state funding of capital outlay in 1971.

Other states reported no grants for capital outlay or debt service.

School Construction Expenditure Trends

United States Office of Education statistics[8] reveal that total school capital outlay increased from about $1 billion in 1949-50 to more than $4.5 billion in 1970-71. It is generally estimated that about 98 percent of capital outlay is for school building related purposes, with the remainder allocated for school transportation equipment. In addition to the reported total expenditure for capital outlay, interest on debt required more than $1.3 billion in 1970-71 compared to 100 million spent in 1949-50.

Several reasons are evident for the recorded increases in capital outlay and debt service expenditures. Major enrollment increases occurred in the two decades and changing educational programs had increased space and equipment needs. The school district reorganization movement resulted in the need for replacement of small and otherwise inadequate school buildings. Migration from rural to urban and suburban areas has had significant impact. The financial problems of non-public schools and the resulting shift of pupils to public schools has also contributed to school building needs.

The school building problem in many cities has been quite acute. Contributing factors have included the decline of the central cores, civil rights problems, urban renewal, and difficulty of acquiring suitable sites.

The decreased purchasing power of the dollar has been a major influence on the rising costs of school construction and related debt service. Labor costs increased more than 50 percent from 1959 to 1970, and material costs also rose substantially.[9]

Since approximately 70 percent of school construction is financed through issuance of bonds,[10] interest rates incurred bear significantly upon ultimate costs of school construction and relate directly to debt service costs. Interest rates on school building bonds reached historic high levels in the early 1970's, and will thus impact debt service costs for years to come.

Future Construction Needs

During the 1960's, approximately half of the 70,000 classrooms constructed annually were for housing enrollment increases. Little need is seen for classroom construction for that purpose in the next few years since the birth rate has declined so dramatically. However, specific localities will continue to experience enrollment increases due to population shifts. This fact relates directly to one of the major inequities in state arrangements for financing school buildings - extent of need is very uneven within a state and is usually unrelated to fiscal capacity.

According to a 1968 study[11] by the U.S. Office of Education, more than 500,000 classrooms were needed in the United States to replace antiquated and obsolete buildings. A backlog of construction need was created during the depression of the 1930's and during World War II; much of this backlog remained during the post-war years as facilities which normally would have been replaced were continued in use as school districts tried to accommodate rapid enrollment increases.

Projection for the 1970's indicated that about 20,000 classrooms would be constructed annually to replace obsolete facilities while 50,000 would be built each year to accommodate pupil population shifts and for new programs. During the early 1970's, two conditions existed which have perhaps caused the backlog to further increase; these were voter rejection of school building referenda and prevailing bond interest rate levels which were in excess of statutory or constitutional limitations.

A major conclusion of the NEFP study of school construction financing was that an annual average of 123,000 classrooms should be constructed during 1970-1980. The total annual cost, in 1968 dollars, would be $7.8 billion, assuming average classroom construction cost at $63,000. This projection envisioned complete elimination of the backlog and provision of adequate facilities for expanding programs for handicapped children, for vocational education, for early childhood and for the culturally and economically disadvantaged.[12]

More recent data regarding construction needs and costs lead to the conclusion that the backlog is increasing and that the various states will continue to be confronted with substantial school construction dollar needs for many years. School Management's 1973 Cost of Building Index[13] showed that the number of classrooms constructed in recent years were: 1968 - 69,511; 1969 - 63,018; 1970 - 45,734; 1971 - 51,742; 1972 - 53,146; and the estimate for 1973 was 42,906. Cost per classroom had increased from $53,000 in 1968 to an estimated $87,000 in 1973.

Representative State Programs and Fiscal Neutrality

State programs for financing school construction or debt service can be generally categorized as follows:

1. Total state assumption.

2. Grants, for construction, based upon a fixed or variable percentage of approved project cost.

3. Grants, for construction or debt service purposes, which are part of (or closely) related to) the program which allocates funds for financing current operation.

4. Grants for debt service.

5. State loans for construction.

6. No state participation.

Only two states, Maryland and Hawaii, assume all local district construction costs. Since the fiscal neutrality doctrine requires that the wealth of the state, rather than the wealth of the districts, be the determinant of the level of spending, the programs of Maryland and Hawaii meet the test if all essential project costs are included.

Recent studies of several state capital outlay and debt service programs have been made for the National Educational Finance Project and by doctoral students at Indiana University. Recent data are thus available which show the consequences of typical state programs which fit into categories two through six above. Selected data from these states are summarized in the following table.

Comparative Data on Per Pupil Debt, Debt Service, and Debt Service Tax Rates for Selected States

State	Year	District Debt Per Pupil			District Debt Service Per Pupil			District Debt Service Tax Rates* (per $100)		
		Low	Median or Mean	High	Low	Median or Mean	High	Low	Median or Mean	High
Delaware	1970-71	$84	$564	$1,906	$13	$68	$130	$.06	$.25	$.47
Indiana	1971-72	0	806	2,949	0	81	224	0	.27	.65
Iowa	1969-70	0	N.A.	N.A.	0	52	154	0	.15	.50
Kentucky	1971-72	0	664	1,958	0	41	170	0	N.A.	N.A.
Virginia	1972-73	0	800	1,531	0	80	180	0	.13	.44

*All tax rates have been converted to reflect assessment of taxable property at 100 percent of actual valuation.

Delaware. The Delaware program for state assistance with school building financing has long been regarded as exemplary by school finance scholars. The level of state participation in financing approved project costs of new buildings has been at least at the 60 percent level for many years, with vocational education buildings and all special education facilities (except for the educable mentally handicapped) funded entirely by state funds. Local districts raise the difference between the amount of the state grant and total project costs solely by issuance of bonds, with total bonded debt limited to ten percent assessed valuation.

A recent study of the Delaware program contained the following key findings and conclusions.[14]

Total debt of all local school districts in 1970-71 was $74 million, or $564 per pupil. Bond leeway for all districts was $109 million, or about $843 per pupil. Local debt service was $8.4 million, or about $67.94 per pupil.

The typical Delaware school district has sufficient local debt leeway to permit construction of needed school buildings, but leeway was far from uniform among the 23 districts. Expressed in dollars, leeway ranged from $101 to $1,735 per pupil. Expressed as an index number, with the state average as 100, the range was 12 to 206. A few of the districts could not raise the required local 40 percent for a major project within the ten percent bonded debt limitation.

Bonded debt per pupil ranged from $84 to $1,906. Expressed as index numbers, with the state average as 100, the range was 15 to 333.

A wide range was also found in debt service tax rates based on full valuation of property. The lowest rate was 6 cents; the highest was 46.9 cents. Property valuation was not the sole determinant of disparities in rates, since school building needs and local aspirations

also tended to be influential, but the 3 to 1 range strongly indicates that the existing program has failed to equalize fiscal burden among the districts.

Examination of data for two districts illustrates the failure of the existing program to meet the fiscal neutrality test. The Alexis I. duPont district ranked first in full valuation per pupil, in bonded debt per pupil, and in debt leeway per pupil; yet its rate for debt service was lower than the median rate for all districts. The fact that the per pupil wealth was 2.38 times the state average enabled the district to have substantially more debt per pupil, greater debt leeway, and a lower tax rate than poorer districts.

Data for the Newark district illustrate the situation for a poorer district which has been faced with school building needs. Newark ranked 16th in wealth per pupil, second in debt per pupil, and last among the 23 districts in debt leeway per pupil. Newark ranked third in debt service tax rate.

A comment in the Serrano decision is applicable to the data for the Newark and Alexis I. duPont districts. The court said: ". . . affluent districts can have their cake and eat it too; they can provide a high quality education for their children while paying lower taxes. Poor districts, by contrast, have no cake at all."[15]

Kentucky. Data for Kentucky were obtained from a 1973 NEFP study.[16] Kentucky grants $1,300 per instructional unit to all school districts for capital outlay and debt service as part of the Minimum Foundation Program. Local school building funds are also obtained by bond issues, special voted building taxes, and from current revenues.

A relatively high percentage of capital outlay and debt service requirements is funded by the state. In 1971-72, of $68 million spent by all districts for capital outlay and debt service, $25 million, or about 37 percent was provided by the Minimum Foundation Program grants. State allocations amounted to $37.6 million but several districts used all or part of the grant for current operation purposes.

Total bonded debt of all districts was $469.2 million in 1971-72. An assessment for all districts revealed construction need of $309 million as of December 1972. Total bonding capacity, for all districts, was $142.8 million. Thus, need far outstrips present capacity.

Matarazzo[17] concluded that the existing program did provide some equalization of local ability to provide buildings. He also pointed out these problems:

1. Bonded debt leeway ranged from $66 per pupil to $1,353, with a state-wide average of $202. Leeway was dependent upon prior school building effort and assessed valuation.

2. Bonded debt per pupil ranged from $0 to $1,958.

3. Twenty-three districts had no construction need, 74 districts had sufficient bond leeway to construct needed buildings, and 116 districts had needs in excess of bonding potential. Three large districts had 27 percent of the capital needs for the state.

4. Several school districts were able to allocate state-granted capital outlay funds for current operating purposes since grant amounts exceeded debt service and capital requirements.

5. There was great disparity among the districts with the respect to willingness to impose special voted building taxes. Nearly two-thirds of the districts (63 percent) had a special voted building tax.

6. Districts with increasing enrollments, even with relatively high special voted additional taxes, were unable to finance needed projects.

7. Total tax rate for all school purposes ranged from 27.3 cents to $1.572 per $100 of full valuation. Since the capital outlay grant program is an integral part of the state foundation program, it is difficult to precisely discern the disparity to be attributed directly to school construction but it is safe to conclude that the range in school building needs does affect total rates.

The combined effect of the disparities among districts in the amount of debt per pupil, in the use of state capital outlay grants proceeds, in bonding ability, and in tax rates lead to the conclusion that the Kentucky program could not meet the test of fiscal neutrality. The Kentucky program, generally categorized as a variant of the Strayer-Haig concept, appears to use state funds in an indiscriminate manner with respect to local districts' fiscal capacity, need, and effort. The same conclusion would probably be reached after an analysis of other similar state programs.

Indiana. Indiana makes a flat grant of $40 per pupil in average daily attendance to be used by receiving districts for debt service payments. If the district receives a larger sum than its debt service requirements, it may use any excess for current operation

purposes. Indiana also has two loan programs; the maximum loan amount is $750,000 for the Common School Fund and $250,000 for the Veterans Memorial Fund. Local districts may issue general obligation bonds up to two percent of assessed valuation for school building purposes, may reserve the proceeds of a cumulative building fund levy, and may lease facilities from non-profit or private school building corporations.

Hile[18] analyzed the Indiana state grant program for the 1969-70 school year. Total debt service payments were $64 million, with the state grants totalling $44 million. Of the total granted, $9.7 million was diverted to current operation purposes by districts which did not need a portion or all of the grant to meet debt service needs. Total school building debt was approximately $850 million, or about $800 per pupil.

Of the 314 school districts, 210 had debt service obligations which exceeded the grant amount. Thirteen districts had no debt service requirements, and the remaining 91 districts used $9.2 million of the granted funds for debt service and $9.0 million for current operation.

Local tax rates levied for school facility purposes ranged from zero to $3.36 per $100 of assessed valuation. Indiana taxable property is assessed at 33 1/3 percent of true value.

Property tax relief caused by the $40 per pupil grant for local school districts averaged 38.6 cents. The range was $0.09 to $1.49.

Wilkerson and Barr further analyzed data for the 10 wealthiest, 10 poorest, and 20 Indiana districts with approximately average wealth.[19]

The median debt service tax rate for the 10 wealthiest districts was zero, for average wealth districts was 42 cents, and for the poorest districts was $1.13 per $100 of taxables. Range of total school building tax rate for the 40 selected districts was zero to $2.56 per $100, with poorer districts having higher rates.

Debt per pupil for the 40 districts ranged from zero to $2,690. One of the wealthy districts had the highest amount of debt per pupil, yet had a total school building tax rate of only 77 cents.

A poor district which had per pupil debt of $1,198 and debt service requirements of $115 per pupil had the highest total school building rate. ($2.56)

The net result of the Indiana program is similar to that of Kentucky. Since both states allocate funds on an arbitrary basis, $1,300 per classroom unit in Kentucky and $40 per pupil in Indiana, this conclusion is to be expected. In each state, equalization is ill-served by the existing progtam and the test of fiscal neutrality is not met.

Virginia. In Virginia, school construction is a local district responsibility with current funds and proceeds of bond issues providing the bulk of school building dollars. Virginia is also one of 14 states which loans school building funds to local districts.[20]

An analysis of Virginia's system of school construction financing was made as part of an NEFP study for the state.[21] Key findings and conclusions of that analysis follow.

1. Average capital outlay for Virginia schools has approximated $100 per pupil in recent years.

2. Need projections indicate that school construction expenditure will average about $100 per pupil annually through 1980.

3. The debt service burden is growing and averaged about $80 per pupil in 1972-73. Per pupil debt averaged $800.

4. Wide variability existed among school districts in the amount of debt per pupil. While median per pupil debt in 1970 was about $450 the mean amount was about $620; the discrepancy can be attributed to the fact that districts with large enrollments have greater per pupil debt than do smaller districts.

5. Analysis of data for the ten wealthiest, ten poorest, and ten districts with average fiscal capacity showed that:

   a. Debt per pupil ranged from $43 to $1,389 for the wealthy group; from $395 to $952 for the average group; and from $158 to $608 for the districts with low fiscal capacity.

   b. Debt service per pupil ranged from $12 to $180 for the ten wealthy districts, from $36 to $70 for the average districts, and from $21 to $53 for the poorest districts.

   c. Debt service tax rates (based on full valuation of property) ranged from 2 cents to 22 cents for the wealthy, from 8 cents to 25 cents for the average districts, and from 10 cents to 26 cents for the low capacity districts.

d. The significant effect of local fiscal capacity was made clear by the fact that a true value property tax rate of 22 cents per $100 of taxables yielded $180 per pupil for Alexandria, $66 for Roanoke County, and $38 for Tazewell County.

6. Calculated true value debt service rates, for all Virginia districts, ranged from zero to 44 cents while the median rate was 13 cents.

7. A survey of school construction needs revealed that those districts which presently had relatively high debt and debt service burdens would have more future need than districts with moderate or low per pupil debt and debt service.

The wide disparities among Virginia school districts in existing debt, debt service, and need indicate that the existing system falls far short of meeting the test of fiscal neutrality.

Iowa. Iowa is one of several states which neither grants nor loans funds to local districts for debt service or school construction purposes. Districts may issue school building bonds amounting to no more than five percent of actual valuation of taxable property. Debt service is limited to a ten mill tax rate, except that the rate may be increased to 15 percent if 60 percent of voters in a referendum so permit. Districts are also permitted to establish a 2.5 mill schoolhouse levy.

White analyzed 1969-70 debt service of 453 Iowa districts.[21] Salient findings and conclusions of his study follow.

1. Debt service ranged from zero to $154 per pupil with a state average of $52.

2. Seventeen districts had no debt service. All of these had above average wealth and small enrollments.

3. Percent of bonding power utilized, for all 455 districts, ranged from zero to 74 percent. The mill levy restrictions prevented many districts from utilizing 100 percent of bonding capacity.

4. More wealthy districts spent more per pupil for debt service than the less wealthy districts. A statistically significant positive relationship existed between wealth per pupil and debt service per pupil.

5. Districts with above average current expenditure per pupil tended to spend more per pupil for debt service than districts with lower per pupil current expenditures. Fiscal capacity thus appeared to be a major determinant of spending for both current and facility-related expenditures.

6. No significant relationship was found between districts' average daily membership and debt service per pupil.

7. The local tax rate necessary to fund average debt service ($52) was approximately 4 mills. For all districts, the range in the amount of levy necessary to raise the state average was from 1.3 to 9.7 mills. The poorest school district needed to make seven times the effort required of the richest district to raise $52 per pupil.

8. During 1969-70, 98 districts utilized the 2.5 mill schoolhouse levy. The average per pupil equalized valuation of this group of districts was $10,672, or about 18 percent lower than the state

average of $13,065. Average debt service levy for this group of districts was 4.966 mills compared to the state average of 4 mills. Per pupil debt service of this group was about the same as the average for all districts. These findings again show that poorer districts must make substantially greater effort to fund school facility-related expenditures than is the case for wealthier districts.

The consequences of the Iowa program are quite similar to those of the Kentucky, Indiana, and Virginia systems. It is likely that even greater disparities among districts might have been found had not millage restrictions prevented districts from utilizing 100 percent of their bonding capacity.

Towards Fiscal Neutrality

Examination of the data from representative state programs leads to the general conclusion that typical existing schemes for financing school construction fall far short of adhering to the principle of fiscal neutrality. This generalization is probably applicable to all states except Hawaii and perhaps Maryland.

Twenty-five of the 50 states grant no construction or debt service funds to local school districts. Bond issue proceeds, state loans, and local reserve funds are used to construct facilities and property tax revenues become the ultimate source of funds. Since so much construction is financed by bond issues, it is appropriate to mention that the fiscally weak districts are usually confronted with the double penalty of higher interest costs on borrowed funds and higher tax rates to service debt.

While local district wealth is one of the key factors in determining school construction tax rates for school construction, it generally is the sole determinant of the extent to which bonds can be issued so that school construction needs can be satisfied. The quality of a child's education, at least in regards to the facilities which house the educational program, is thus clearly a function of the wealth of the district.

Data from Kentucky and Indiana revealed that state aid programs which grant funds on per pupil or instructional unit bases may allow some districts to divert such funds for current operation purposes; when this occurs, the net effect is to reduce the equalization tendencies of the state system for funding current operation. Put another way, the principle of fiscal neutrality is grossly violated in respect to school construction and the state's current operation funding scheme is distorted to favor districts with little or no construction or debt service needs.

Data from Delaware showed that even a relatively high level of state participation in construction funding still can result in wide inter-district inequities in debt, debt service, tax rates, and capacity to finance needed projects.

School capital outlay and debt service expenditures were estimated to total $7.9 billion of the $40.6 billion expended for public elementary and secondary schools in 1969-70.[23] Thus, school construction related expenditures were consuming about one-fifth of education's dollar. For capital outlay and interest on debt, 1970-71 expenditures were $5.9 billion, or about 13 percent of $45.5 billion total expenditures.[24] Whether one considers all debt service

and capital outlay, or only interest on debt and capital outlay, school construction related expenditures are of sufficient magnitude that they should not be ignored in the planning of improved school finance systems.

The United States Supreme Court, in its recent decision,[25] charged state lawmakers, and the citizens who elect them, to reform existing finance systems which have relied too long and too heavily on the property tax. The Court also indicated that high levels of quality and greater uniformity of opportunity should be sought.

What types of funding schemes might provide fiscal neutrality in provision of school buildings? Several alternative plans have been advanced for state-local financing of current operation. These could be examined to ascertain whether they might be appropriate for financing construction and debt service.

Rossmiller[26] pointed out that application of "Serrano" theory to the funding of school facilities would encounter problems which may differ from those encountered in financing current programs. While a rough dollar approximation of average annual current per pupil need can be ascertained on a statewide basis, this is simply not the case for school facilities. As even the limited data cited previously in this report indicate, need for construction and debt service dollars varies greatly among districts. School building or debt service need does not occur in regularly predictable patterns. Further, bond ratings and resultant interest costs vary greatly among districts.

Full State Funding. General agreement has been reached by students of school finance that full state funding meets the test of fiscal neutrality if all essential costs are absorbed by the state.

Local district wealth does not become the determining factor of the extent to which pupils' needs can be satisfied; nor is the level of local aspirations important.

In the case of school facilities, equity would require that existing debt service, as well as all future construction costs, be assumed by the state. To do otherwise would reward districts which had not made prior effort at the expense of those which had.

The source of state funds for such a program might include some type of uniform effort on the part of all local school districts, but if this were the case the tax would be considered to be a state tax, even though levied locally.

Power Equalizing. One program for state-local sharing in financing of current operation, which in the judgment of several school finance writers satisfies the test of fiscal neutrality is now called "district power equalizing." While variations of this program have existed for many years, it has recently gained several advocates who believe that it can meet the test of equal access to dollars and yet leave program and resulting expenditure decisions at the local level.

Under this plan, the potential amount of funds available to a given district is determined by the extent of local effort. The state contribution, if any, is inversely related to the taxable wealth of the district in such a manner that any two districts making identical local effort have equal dollars available. No specified local tax rate is required nor is there any limit on the amount of the state's contribution. Very wealthy school districts may be required to share locally raised revenues with the state.

A power equalizing scheme could be devised for school construction and/or debt service. Some inherent problems are apparent, however. States would probably be reluctant to adopt such a plan because of the lack of state fiscal control. While fiscal neutrality could be achieved in that any districts wishing to spend equal amounts for a project, or for debt service, could make identical local effort, the fact that each districts' needs can never be identical within a state means that equity with respect to tax burden and capacity are unattainable.

There is perhaps one possible place for a power equalizing program in conjunction with a full state funding program. If a state were to assume all of the construction costs of approved projects, with an appropriate objective formula used to determine costs which would be eligible for state assumption, a power equalizing scheme could be used to allow all districts to make the same effort to obtain locally desired extra features for their facilities.

There is now some conjecture as to whether future courts might disallow use of power equalizing schemes. In the Robinson decision, it was stated that, "Education was too important a function to be left to the mood - and, in some cases the low aspirations of a given district, even whose children attend schools in the district."[27]

Strayer-Haig Programs. The state-local financing scheme used by most states for funding current operation is based upon guaranteeing a fixed amount of dollars per pupil or per instructional unit to all districts which make uniform local tax effort. The proceeds of the local effort are deducted from the guaranteed program amount and the state grants the difference to each district. These state grants do

equalize fiscal capacity among the districts in that the state subsidy is inversely related to local capacity. However, if districts are permitted to use local revenues to raise additional funds then fiscal neutrality is violated since richer districts can obtain a given amount of additional dollars with lower tax effort than poor districts.

Since need is not uniformly distributed each year among all districts, Strayer-Haig or minimum foundation programs do not seem to be appropriate for financing school construction. Data for Kentucky, which does grant capital outlay and debt service funds to all districts under such a scheme, indicated that the grant amount was woefully inadequate for many districts while other districts had no need for such funds. The net effect in Kentucky was that the minimum foundation program for school construction purposes was seriously distorting the equalization tendencies of the state current operation program.

Other Plans. Percentage equalizing plans are closely related to both power equalizing and Strayer-Haig type programs. A mandated minimum amount of dollars must be made available from combined local and state sources. Districts are permitted to raise funds in excess of the minimum program amount and the state continues to grant funds at the same percentage ratio established for the minimum expenditure level. Ordinarily such programs have a stipulated maximum expenditure level for state participation, but districts can go beyond that level with locally raised revenues.

Strayer-Haig programs with minimal local leeway provide another option, as do flat per pupil grants. None of these schemes, as presently used, are appropriate for funding school buildings or debt service, again because of the wide variability of need among districts.

Steps could be taken by the various states to improve existing state-local arrangements for financing construction and debt service so that measurable progress toward fiscal neutrality could be attained. Such a recommendation[28] was made by a Florida citizens committee which endorsed moving from the existing minimum foundation plan to state assumption of all construction costs and all existing debt service. Reasons given for this recommendation included inadequate previous state appropriations, reluctance of local taxpayers to vote needed bond issues, inequitable distribution of state funds, and the failure of the existing state program to adequately consider local building needs or wealth differentials.

A consultant study for Delaware[29] recommended that the state move from its existing program of assuming 60 percent of approved project costs to full assumption of approved project costs. In addition, it was recommended that the state assume all local debt service costs (related to previously approved projects) in excess of the proceeds of a uniformly imposed local property tax rate of six cents per $100.

Programs of full state funding, such as those proposed for Florida and Delaware, may seem too radical for other states, particularly those which have traditionally considered school construction financing to be purely a local responsibility. Perceived disadvantages of full state funding include:

1. The possibility that local districts will become fiscally irresponsible since only state funds will be allocated to projects.

2. Local interest and initiative might be reduced or eliminated.

3. Uniformity of expenditures among all school districts might result eventually in similar levels of mediocrity.

4. The potential drain on the state treasury and the political consequences to legislators who vote to impose increases in state taxes are formidable problems.

5. There would be probable need to increase the size of the staff of the state education agency in order to achieve more rigid control over school building projects.

Rossmiller[30] stated that movement towards much higher levels of state support appeared inevitable, but that progress would probably occur on a broken front. Plans adopted by individual states would vary in accordance with situations confronting each state.

Barr and Wilkerson[31] shared Rossmiller's belief and accordingly developed broad guidelines for state grant programs for school construction and debt service. Adherence to these guidelines would achieve greater inter-district equity and would thus assist states to move towards fiscal neutrality. Pertinent guidelines follow:

1. Determination of local district need is of prime importance and can not be accomplished by using an identical per pupil amount for all districts. Suggested procedures for arriving at need include:

   a. The state education agency should assume major responsibility in assessment of district facility needs. This responsibility could be met by utilizing in-house experts or by contracting with competent professionals.

Few state educational agencies presently are sufficiently staffed to conduct comprehensive school plant surveys for all districts. Those districts which are comparatively well-off financially frequently can afford to hire their own school plant planners or have the funds to obtain expert consultant assistance. Poorer districts, if left to their own devices to orderly determine school facility needs, may have neither competent staff with sufficient time for this activity nor funds to obtain consultants.

Prudence and equity require that state funds for school building purposes be allocated in such a manner that higher priority needs within the state are met first. As was shown previously by the data for Kentucky and Indiana, per pupil grants of arbitrary amounts have the effect of widening inequities of school districts' fiscal capacity. Careful analyses of existing facilities, projected enrollment, and educational program requirements are essential if need is to be scientifically and objectively determined.

b. Funding levels should be responsive to general economic conditions so that changes in building costs can be accommodated.

Even when dollar measures of need are determined on the basis of prevailing costs for given facilities, such measures quickly become obsolete. School building costs have risen dramatically, and the formula which was appropriate in 1969 may be woefully inadequate in 1973.

c. Intra-state differences in construction and site acquisition costs should be considered.

This recommendation is difficult to implement because of the lack of valid information on price differences for school facility components for areas within a state. The Ohio loan-grant program attacked the problem by using regional cost indices developed by the Ohio Association of Architects to determine the dollar allocation for projects. This approach seems feasible and could be adopted by other states.

It should be noted that sole reliance on differences in prevailing wage scales among areas of a state may not be adequate to channel funds in accordance with needs. Hehr[32] found that the Kentucky region with the lowest prevailing wage rates had the highest square foot construction costs of all new schools built in the state in 1970-71 and 1971-72. He also found that the region with the highest prevailing wage rate had the third lowest construction costs of the 12 regions. Apparently the supply of craftsmen in a particular area was more influential than prevailing wage rates, since projects in those regions with low rates often utilized craftsmen who were imported from metropolitan areas and who were given subsistence allowances in addition to the high wages prevailing in their home region.

Sites are often difficult to obtain and very expensive in urban areas. This factor can heavily influence ultimate project costs and should be fully recognized when grant programs are devised.

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32 Hehr, George P., An Analysis of Kentucky's Capital Outlay Program, unpublished doctoral dissertation, Indiana University, Bloomington, 1974.

d. All essential elements of construction costs, including site acquisition and development, furniture, equipment, and fees should be recognized.

A fixed dollar per square foot grant allowance may be appropriate for some projects but not for others. For example, the lack of water or sewage facilities at the site can result in extremely high site development costs for a rural project when compared to a similar project where these services are readily available. Similarly, differences in equipment needs can result in sizeable cost differences between two facilities which may house the same number of pupils.

e. The nature of the educational program to be housed should be a major consideration.

Several states base grant amounts on the grade levels to be housed in recognition of the fact that varying educational program needs result in variations in project costs. New York's 1969 project allowances were $2,108 per pupil in K-6, $3,075 per pupil in grades 7-9, and $3,293 per pupil in grades 10-12. Other states allow more square footage for secondary school projects than for elementary. Equitable treatment of all districts would require that grants vary in accordance with program needs.

f. Special factors such as racial integration, sparsity or density, intra-district migration, obsolete facilities and other problems should be recognized.

Because of the decline of the birth rate, many districts now find that they have excess classrooms. However, for a variety of reasons, there still may be the necessity for additional construction. The need to achieve racial balance may require that ghetto facilities no longer be used.

The population decline in the core city may result in need for additional facilities in the suburban areas and abandonment of center-city buildings.

Many districts have educationally obsolete facilities which have been continued in use. In determination of need, quality of existing buildings should be considered.

g. Existing debt and attendant debt service should be considered.

Existing debt represents prior school building effort and existing debt service contributes to fiscal burden. Both of these factors should be considered by the state in appraising need and capacity of local districts.

2. The systems of districuting state funds according to district need may vary. If full state funding is not feasible, the following items should be considered:

a. State funds should be distributed in inverse relationships to local ability. This does not imply that the local property tax base is the sole determinant of local ability; other measures might be more appropriate.

b. Prior fiscal effort should be recognized. Districts which have previously taxed heavily for school building purposes should not be penalized vis-a-vis other districts which have made little local effort.

c. Local districts should not be required to short-change the current operation program in order to participate.

d. Districts should be permitted to raise the required local share by use of reserve funds, borrowing, or from current revenues, depending upon local circumstances.

The NEFP study[33] of school construction financing concluded with extensive discussion of eight alternative programs with the expressed intention of providing a range of possible choices for the several states. The eight programs included:

1. Equalized grants based upon recognized project costs.
2. Loans with forgiveness for poorer districts.
3. Loans with repayment schedule based upon local capacity.
4. Equalized incentive grants based upon locally determined project cost.
5. Total state and/or federal assumption of school building costs.
6. Equalized grants for clusters of school districts.
7. Equalized grants based upon state average plant depreciation.
8. Equalized grants for debt service.

As these eight programs were originally conceived, probably only number 5 would fully satisfy the fiscal neutrality test. However, each of the suggested programs was accompanied by lists of possible modifications which would enable any of the programs to provide relatively high degrees of inter-district equalization of capacity to finance needed school construction for all pupils.

Conclusion

Fiscal neutrality, although not specifically required by the United States Supreme Court, is a worthy goal which should be sought as the several states plan school financing. School construction and debt service expenditures are of sufficient magnitude to cause tremendous inter-district inequities of capacity to satisfy needs and of tax burdens. While most traditional financing systems may not violate the Constitution of the United States, they may not adhere to requirements of state constitutional provisions and are certainly inequitable.

Shannon[34] has indicated that there is no reason for those who seek fair and adequate funding of education to despair since public attention has been focused upon existing inequities. Perhaps the movement for reform will sustain sufficient momentum so that all children will enjoy the privilege of attending school in adequate facilities -- regardless of the taxable wealth of the district in which they happen to reside.

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